Legislative Audit Division

State of Montana

Report to the Legislature

December 1998

Financial-Compliance Audit

For the Fiscal Year Ended June 30, 1998

State Compensation Insurance Fund

We performed a financial-compliance audit for the fiscal year ended June 30, 1998. This report contains the audited financial statements and accompanying notes for fiscal year 1997-98. We issued an unqualified opinion on the financial statements. The opinion means the reader may rely on the financial statement information presented.

The current report contains no recommendations to the Fund.

Direct comments/inquiries to:
Legislative Audit Division
Room 135, State Capitol
PO Box 201705
Helena MT 59620-1705

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1999, will be issued by March 31, 2000. Copies of the Single Audit Report, when available, can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

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LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel
Tori Hunthausen, IT & Operations Manager

Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
James Gillett, Financial-Compliance Audit

December 1998

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the financial-compliance audit of the State Compensation Insurance Fund for fiscal year 1997-98. The objectives of our audit were to determine the agency's compliance with applicable laws and regulations, make necessary recommendations for improvements in management and internal controls, and determine if the financial statements present fairly its financial position at June 30, 1998, and the results of its operation for the fiscal year then ended.

State Fund is a workers' compensation insurance company established by the State of Montana. It is a nonprofit, independent public corporation that provides Montana employers with an option for workers' compensation and occupational disease insurance. State Fund is governed by a seven-member board of directors appointed by the governor. State law separates funding sources for claims incurred before July 1, 1990 (Old Fund) and those incurred on or after July 1, 1990 (New Fund). State Fund management must set premium rates at amounts sufficient to recover present and future costs of all claims to maturity and to meet reasonable expenses of conducting the business of the New Fund. The Old Fund costs are funded by the Old Fund Liability Tax and investment earnings. The New Fund also contributed capital to the Old Fund; $90.7 million in the form of a dividend and $63.8 million as required by state law. The investments of the State Fund are managed by the Montana Board of Investments and invested according to policies established in law.

On page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion which means the reader can rely on the presented information. State Fund's response to this report is on B-1.

We thank the State Compensation Insurance Fund staff for their cooperation and assistance during the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

Room 135, State Capitol Building, PO Box 201705 Helena MT 59620-1705
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State Compensation Insurance Fund	Carl Swanson	President/CEO
	Mark Barry	Senior Vice President, Administration and Finance
	Jim McCluskey	Vice President, Claims
	Michael Glass	Vice President, Underwriting
	Nancy Butler	Vice President, Legal
	Joanne Shydian	Vice President, Communications and Human Resources
	Connie Brooks	Vice President, Management Information Services

			Term Ending
State Fund Board of Directors	Jim Brouelette, Chairman	Missoula	4/2001
	Brian Donahue	Billings	4/2001
	Tom Horn	Cohagen	4/1999
	Herb Leuprecht	Butte	4/2001
	Lorretta Lynde	Helena	4/1999
	Jack Morgenstern	Lewistown	4/2001
	Laurie Shadoan	Bozeman	4/1999

For additional information concerning the State Compensation Fund contact Carl Swanson, President/CEO, at:

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Helena MT 59601
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Members of the audit staff involved in this audit were Wayne Kedish, Pearl M. Allen, Geri Hoffman, Christopher G. Darragh, and Laura L. Norris.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
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Deputy Legislative Auditors:
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INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Balance Sheets, New Fund and Old Fund, of the State Compensation Insurance Fund, a component unit of the state of Montana, as of June 30, 1998 and 1997 and the related Statements of Operations and Changes in Fund Equity, New Fund and Old Fund, and Statements of Cash Flows, New Fund and Old Fund, for the two fiscal years then ended. The information contained in these financial statements is the responsibility of the State Compensation Insurance Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Compensation Insurance Fund as of June 30, 1998 and 1997, and the results of its operations and of its cash flows for the two fiscal years then ended, in conformity with generally accepted accounting principles.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

September 30, 1998

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Financial Statements

The Montana State Fund is a component unit of the State of Montana.

Balance Sheet (with comparison to prior fiscal year end)

New Fund

	(thousands of dollars) As of June 30, 1998	As of June 30, 1997 (restated)
Assets		
Cash in Treasury	$1,804	$2,717
Short-term Investment Pool (Note 1)	15,326	25,473
Premium Receivable (Note 1)	11,445	13,342
Allowance for Doubtful Accounts	(429)	(419)
Due from Other Funds (Note 1 and 6)	1,650	1,858
Interest Receivable	6,417	6,688
Short-term Notes & Loans Receivable	28	117
Long Term Securities (Note 1, 2)	427,036	439,185
Cash Collateral - Securities on Loan (Note 1)	98,072	100,496
Supplies Inventory	42	49
Equipment (Note 1)	2,235	3,864
Less Accumulated Depreciation	(1,301)	(2,053)
Intangible Assets	6,944	6,400
Property Held in Trust	386	494
Other Assets	4	5
Total Assets	$569,659	$598,216
Liabilities and Fund Equity		
Liabilities:		
Estimated Claims Liability (Note 4)	$310,687	$315,107
Liability for Securities on Loan	98,072	100,496
Deferred Revenue	15,410	16,387
Security Deposits (Note 1)	462	695
Accounts Payable	1,320	944
Due to Other Funds	730	693
Compensated Absences (Note 8)	731	680
Total Liabilities	$427,412	$435,002
Fund Equity:		
Restricted Fund Balance (Note 7)	$10,000	
Unrestricted Fund Balance	132,247	163,214
Total Fund Equity	$142,247	$163,214
Total Liabilities and Fund Equity	$569,659	$598,216

The notes are an integral part of the financial statements.

Statements of Operations and Changes in Fund Equity (with comparison to prior fiscal year end)

New Fund

	(thousands of dollars) Year Ended June 30, 1998	Year Ended June 30, 1997 (restated)
Underwriting Results		
Premium	$77,426	$89,142
Less: Reinsurance Premium Paid	(312)	(334)
Safety Incentive Refunds	(102)	(320)
Volume Discounts	(591)	(334)
Claims Expenses:		
Compensation Benefits Paid	30,263	33,421
Medical Benefits Paid	26,406	23,694
Allocated Loss Adjustment Expenses	2,388	1,262
Change in Estimated Claims Liability	(4,420)	20,630
Other Expenses:		
Operating Expenses	11,845	10,940
Bad Debts	1,199	433
Underwriting Gain/(Loss)	$8,740	($ 2,226)
Investment Income	32,481	31,202
Net Increase (Decrease) in the Fair Value of Investments (Note 2)	12,488	4,854
Securities Lending Income (Note 1)	5,309	7,403
Securities Lending Expense (Note 1)	(5,178)	(7,023)
Other Income	36	250
Results of Operations	$53,876	$34,460
Gain on Sale of Fixed Assets		4
Operating Transfer Out (Note 7)	$10,000	
Net Income (loss)	$43,876	$34,464
Residual equity transfer (Note 7)	(63,800)	(90,690)
Contributed Capital Transfer		(11,599)
Prior Year End Fund Equity (as previously stated)	163,214	231,433
Fund Equity as Restated	$143,290	$163,608
Prior Year Adjustment (Note 2)	(1,043)	(394)
End of Period Fund Equity	$142,247	$163,214

The notes are an integral part of the financial statements.

Statement of Cash Flows (with comparison to prior fiscal year end)

New Fund

	(thousands of dollars) Year Ended June 30, 1998	Year Ended June 30, 1997 (restated)
Cash Flows From Operating Activities		
Receipts for Premiums	$77,321	$86,808
Payments to Suppliers for Goods and Services	(3,821)	(4,128)
Payments to Employees	(8,022)	(6,676)
Cash Payments for Claims	(59,081)	(58,345)
Other Operating Revenues	36	206
Net Cash Provided by (Used for) Operating Activities	$6,433	$17,865
Cash Flows From Noncapital Financing Activities		
Return of Contributed Capital		($ 11,599)
Operating Transfer Out	(10,000)	
Residual Equity Transfer	(63,800)	(90,668)
Net Cash Provided by (Used for) Noncapital Financing Activities	($ 73,800)	($ 102,267)
Cash Flows From Capital and Related Financing Activities		
Acquisition of Fixed Assets	($ 1,224)	($ 3,597)
Proceeds from Sale of Fixed Assets	2	15
Net Cash Used for Capital and Related Financing Activities	($ 1,222)	($ 3,582)
Cash Flows From Investing Activities		
Purchase of Investments	($ 115,651)	($ 185,539)
Proceeds from Sales or Maturities of Investments	138,816	230,706
Security Lending Income	5,290	7,403
Security Lending Cost	(5,169)	(7,023)
Interest and Dividends on Investments	34,243	33,150
Net Cash Provided by (Used for) Investing Activities	$57,529	$78,697
Net Increase (Decrease) in Cash and Cash Equivalents	($ 11,060)	($ 9,287)
Cash and Cash Equivalents July 1	28,190	$37,477
Cash and Cash Equivalents June 30	$17,130	$28,190

The notes are an integral part of the financial statements.

Statement of Cash Flows (with comparison to prior fiscal year end)

New Fund

	(thousands of dollars) Year Ended June 30, 1998	Year Ended June 30, 1997 (restated)
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Results of Operations	$53,876	$34,460
Adjustments to Reconcile Operating Income to Net Cash Provided by (Used for) Operating Activities		
Depreciation	222	552
Amortization	212	76
Security Lending Income	(5,309)	(7,403)
Security Lending Cost	5,178	7,023
Interest on Investments	(44,969)	(36,056)
Changes in Assets and Liabilities:		
Decr (Incr) in Accounts Receivable	1,995	(350)
Decr (Incr) in Due From Other Funds	208	(52)
Decr (Incr) in Inventories	7	9
Decr (Incr) in Other Assets	110	310
Incr (Decr) in Accounts Payable	445	441
Incr (Decr) in Due to Other Funds	37	(227)
Incr (Decr) in Deferred Revenue	(977)	(1,287)
Incr (Decr) in Property Held in Trust	(233)	(333)
Incr (Decr) in Estimated Claims	(4,420)	20,630
Incr (Decr) in Compensated Absences	51	72
Total Adjustments	($ 47,443)	($ 16,595)
Net Cash Provided by (Used for) Operating Activities	$6,433	$17,865

The notes are an integral part of the financial statements.

Balance Sheet (with comparison to prior fiscal year end)

Old Fund

	(thousands of dollars) As of June 30, 1998	As of June 30, 1997
Assets		
Cash in Treasury	$407	$499
Short-term Investment Pool (Note 1)	8,904	20,789
Account Receivable (Note 1)	4,775	3,613
Allowance for Doubtful Accounts	(258)	(290)
Due from Other Funds (Note 1)	517	210
Long Term Securities (Note 1)	111,410	
Cash Collateral - Securities on Loan (Note 1)	596	560
Total Assets	$126,351	$25,381
Liability and Fund Equity		
Liabilities		
Estimated Claims Liability (Undiscounted) (Note 4)	$194,401	$205,678
Liability for Securities on Loan	596	560
Deferred Revenue	258	300
Due to Other Funds (Note 6)	1,639	1,824
Arbitrage Rebate Tax Payable		156
Other Liabilities	42	45
Total Liabilities and Fund Equity	$196,936	$208,563
Contributed Capital (Note 7)	$154,468	$90,668
Retained Earnings	(225,053)	(273,850)
Total Fund Equity	($70,585)	($183,182)
Total Liabilities and Fund Equity	$126,351	$25,381

The notes are an integral part of the financial statements.

Statement of Operations and Changes in Fund Equity (with comparison to prior fiscal year end)

Old Fund

	(thousands of dollars) Year Ended June 30, 1998	Year Ended June 30, 1997
Underwriting Results		
Premium	$0	($390)
Claims Expenses:		
Compensation Benefits Paid	8,289	10,274
Medical Benefits Paid	5,755	5,648
Allocated Loss Adjustment Expenses	580	392
Change in Actuarially Estimated Claims (Undiscounted)	(11,277)	(43,124)
Other Expenses		
Administrative Expenses	2,252	2,800
Underwriting Gain/(Loss)	($5,599)	$23,620
Old Fund Liability Tax Revenue	51,963	49,208
Investment Income	2,265	2,735
Net Increase (Decrease) in the FairValue of Investments (Note 2)	169	
Security Lending Income (Note 1)	36	188
Security Lending Expense (Note 1)	(35)	(170)
Interest Expense	(2)	(2,341)
Bond Arbitrage Expense		(16)
Results of Operations	$48,797	$73,224
Other Sources/(Uses) of Funds		
Loss on Bond Defeasance		(3,535)
Net Income	$48,797	$69,689
Capital Contribution - New Fund (Note 7)	63,800	90,668
Residual Equity Transfer		11,599
Prior Year End Fund Equity	(183,182)	(355,138)
End of Period Fund Equity	($70,585)	($183,182)

The notes are an integral part of the financial statements.

Statement of Cash Flows (with comparison to prior fiscal year end)

Old Fund

	(thousands of dollars)	
	Year Ended June 30, 1998	Year Ended June 30, 1997
Cash Flows From Operating Activities		
Receipts for Sales and Services	$0	($388)
Payments to Suppliers		
for Goods and Services	(1,674)	($1,683)
Payments to Employees	(790)	(1,053)
Cash Payments for Claims	(14,584)	(16,332)
Collections of Notes Receivable	32	29
Other operating revenues	51,849	49,229
Net Cash Provided by (Used for)		
Operating Activities	$34,833	$29,802
Cash Flows from Noncapital Financing Activities:		
Payment of Principal and		
Interest on Bonds and Notes	($2)	($129,008)
Contributed Capital from New Fund	63,800	90,668
Residual Equity Transfer - New Fund		11,599
Loss on Debt Extinguishment		(3,535)
Net Cash Provided by (Used for)		
NonCapital Financing Activities	$63,798	($30,276)
Cash Flows from Investing Activities:		
Purchase of Investments	($113,545)	
Proceeds from Sales or		
Maturities of Investments	2,290	$11,100
Securities Lending Income	36	187
Securities Lending Expense	(35)	(170)
Arbitrage Rebate Tax	(156)	
Interest and Dividends on Investments	802	2,910
Net cash Provided by (Used for)		
Investment Activities	($110,608)	$14,027
Net Increase (Decrease) in Cash		
and Cash Equivalents	($11,977)	$13,553
Cash and Cash Equivalents, July 1	21,288	7,735
Cash and Cash Equivalents, June 30	$9,311	$21,288

The notes are an integral part of the financial statements.

Statement of Cash Flows (with comparison to prior fiscal year end)

Reconciliation of Operating Income to Net Cash Provided by Operating Activities:

Old Fund

	(thousands of dollars) Year Ended June 30, 1998	Year Ended June 30, 1997
Operating Income (Loss)	$48,797	$73,224
Adjustments to Reconcile Operating Income to Net Cash Provided by (Used for) Operating Activities:		
Interest Expense	$2	$2,340
Interest on Investments	(2,434)	(2,735)
Securities Lending Expense	35	170
Securities Lending Income	(36)	(188)
Arbitrage Rebate Tax	156	16
Change in Assets and Liabilities:		
Decr (Incr) in Accounts Receivable	285	(167)
Decr (Incr) in Due From Other Funds	(307)	114
Decr (Incr) in Other Assets		
Incr (Decr) in Accounts Payable	(9)	15
Incr (Decr) in Due to Other Funds	(188)	77
Incr (Decr) in Deferred Revenue	(42)	72
Incr (Decr) inArbitrage Rebate Tax Payable	(156)	
Incr (Decr) in Estimated Claims	(11,277)	(43,124)
Incr (Decr) in Other Liabilities	7	(12)
Total Adjustments	($13,964)	($43,422)
Net cash provided by (Used for) Operating Activities	$34,833	$29,802

The notes are an integral part of the financial statements.

Notes to Financial Statements

for the two fiscal years ended June 30, 1998

1. Summary of Significant Accounting Policies

Description of Business

The State Compensation Insurance Fund (State Fund) is a non-profit, independent public corporation established under Title 39, chapter 71 of the Montana Codes Annotated (MCA). The State Fund provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana.

During the fiscal year ended June 30, 1997, the State Fund was governed by a five member Board of Directors appointed by the Governor. The Board of Directors was increased to seven members effective July 1, 1997. The State Fund is attached to the State of Montana, Department of Administration for administrative purposes only.

During the 1990 Montana Special Legislative Session, legislation passed establishing separate funding and accounts for claims of injuries resulting from accidents occurring before July 1, 1990, referred to as the Old Fund, and claims occurring on or after July 1, 1990, referred to as the New Fund.

The New Fund functions as an autonomous insurance entity supported solely from its own revenues. All assets, debts, and obligations of the New Fund are separate and distinct from assets, debts, and obligations of the State of Montana. Upon dissolution of the New Fund, any monies not needed to liquidate the New Fund would be subject to legislative provision according to state law (section 39-71-2322, MCA). The State Fund administers and manages the claims remaining in the Old Fund for the State of Montana and is the administering entity for recording the financial activity related to receipt and disbursement of an Old Fund Liability Tax (see note 4, Old Fund). No State general fund money is used for State Fund operations.

Because of the Governor's appointment of the board members and the state's regulatory oversight function, the State Fund financial statements are presented as a component unit in the State of Montana Comprehensive Annual Financial Report.

Basis of Accounting

The State Fund uses the accrual basis of accounting, as defined by generally accepted accounting principles, for its workers' compensation insurance operations. Under the accrual basis, the State Fund records revenues in the accounting period earned, if measurable, and records expenses in the period incurred, if measurable.

Cash and Short Term Investment Pool

Cash balances include demand deposits with the State Treasury. The State Fund also participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less. There are no legal risks that the Board of Investments is aware of regarding any STIP investments. The market value of STIP approximates cost. The New Fund STIP balance of $15,326,427 as of June 30, 1998, represented 1.4% of the total STIP. The Old Fund STIP balance of $8,903,742 as of June 30, 1998, represented 0.8% of the total STIP. The New Fund STIP balance of $25,472,672 as of June 30, 1997, represented 2.3% of the total STIP. The Old Fund STIP balance of $20,789,495 as of June 30, 1997, represented 1.9% of the total STIP.

The STIP investments' credit risk is measured by investment grade ratings given individual securities. The Board of Investment's policy requires that STIP investments have the highest rating in the short-term category by one and/or any Nationally Recognized Statistical Rating Organizations (NRSRO). The six NRSRO's include Standard and Poors, Moody's, Duff and Phelps, Fitch, International Bank Credit Agency and Thompson's Bank Watch. Asset-backed securities constituted 40.4% of the Board of Investment's total STIP portfolio as of June 30, 1998. Asset-backed securities have less credit risk than do securities not backed by pledged assets. Market risk for asset-backed securities is the same as market risk for similar non asset-backed securities. Asset-backed securities constituted 32.1% of the Board of Investment's total STIP portfolio as of June 30, 1997.

Variable rate (Floating Rate) securities made up 28.4% of the Board of Investment's total STIP portfolio as of June 30, 1998. Variable rate securities made up 32.8% of the Board of Investment's total STIP portfolio as of June 30, 1997. While variable rate securities have credit risk identical to similar fixed rate securities, their market risk (income) is more sensitive to interest rate changes. However, the market risk (value/price) may be less volatile than fixed rate securities because their value will usually remain at or near par as a result of their interest rates being periodically reset to maintain a current market yield.

Long Term Securities

The State Fund invests monies with the Montana Board of Investments, including STIP amounts. Securities are stated at cost and adjusted for amortization of any discount or premium. Premiums and discounts are amortized using the straight-line method over the life of the securities. Net unrealized gains or losses on securities are not included in adjustments to retained earnings. State Fund investments are classified in risk Category 1 or as Not Categorized under State of Montana standards. Risk category 1 includes investments that are insured or registered and held by the Board of Investments or its agent in the Board's name. Not Categorized includes investments held by broker-dealers under loans with cash collateral. Asset-backed securities have less credit risk than do securities not backed by pledged assets. Market risk for asset-backed securities is the same as market risk for similar non asset-backed securities.

Under the provisions of state statutes, the State Board of Investments has, via a Securities Lending Authorization Agreement, authorized the custodial bank to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. State Street Bank was appointed the Board's custodial bank on December 1, 1993. During the period the securities are on loan, the Board receives a fee and the bank must initially receive collateral equal to 102% of the market value of the securities on loan and must maintain collateral equal to not less than one hundred percent of the market value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years 1998 and 1997, State Street loaned, on behalf of the Board, certain securities held by State Street, as custodian, and received U.S. dollar currency cash, U.S. Government securities, and irrevocable bank letters of credit. State Street does not have the ability to pledge or sell collateral securities unless the borrower defaults.

The Board did not impose any restrictions during fiscal years 1998 and 1997 on the amount of the loans that State Street made on its behalf. There were no failures

by any borrowers to return loaned securities or pay distributions thereon during fiscal years 1998 and 1997. There were no losses during fiscal years 1998 and 1997 resulting from default of the borrowers or State Street.

During fiscal years 1998 and 1997, the Board of Investments and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool—the Securities Lending Quality trust. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. On June 30, 1998, and June 30, 1997, the Board had no credit risk exposure to borrowers.

The following table presents the carrying and market values of the securities on loan and the total collateral held for fiscal years 1997-98 and 1996-97 for both the New Fund and the Old Fund:

	New Fund		Old Fund	
	FY 97-98	FY96-97	FY97-98	FY96-97
Securities on Loan-Book Value	$96,399,897	$94,429,794	$0	$0
Securities on Loan-Market Value	$102,345,909	$95,792,393	$0	$0
Total Collateral Held	$107,454,766	$100,496,366	$596,292	$559,720

As of June 30, 1998, investments in the New Fund and the Old Fund include $96,399,897 (approximately 22.6% of total long-term securities) and $0, respectively, in long term securities on loan which earned interest income during the fiscal year of $5,308,940 and $36,387, respectively. As of June 30, 1997, investments in the New Fund and the Old Fund include $94,429,794 (approximately 21.7% of total long-term securities) and $0, respectively, in long term securities on loan which earned interest income during the fiscal year of $7,403,448 and $187,599, respectively. Securities on loan are classified as risk category 1 or are not categorized. Montana's Constitution does not currently allow the State Fund to invest in equity securities.

Receivables

The New Fund premium receivable balance of $11.4 million at June 30, 1998, includes $4.2 million of premium due from insureds for insurance coverage provided during fiscal year 1997-98 not yet received. The remaining $7.2 million represents advance premiums billed but not received for insurance coverage effective July 1, 1998, as part of the State Fund's Premium in Advance program. This amount is offset in deferred revenue. Estimated uncollectible receivables are reported as an allowance for doubtful accounts of $428,546. Other receivables include $6.4 million in investment income due and $1.6 million due from the Old Fund in administrative cost reimbursement.

The New Fund premium receivable balance of $13.3 million at June 30, 1997, included $4.4 million of premium due from insureds for insurance coverage provided during fiscal year 1996-97 not yet received. The remaining $8.9 million represented advance premiums billed but not received for insurance coverage effective July 1, 1997, as part of the State Fund's Premium in Advance program. This amount is offset in deferred revenue. Estimated uncollectible receivables are reported as an allowance for doubtful accounts of $418,749. Other receivables include $6.6 million in investment income due, and $1.8 million due from the Old Fund in administrative cost reimbursement.

Accounts receivable in the Old Fund includes interest receivable, amounts due from past premiums in dispute or in collection, and amounts due from Old Fund Liability Tax collections. Estimated uncollectible receivables are reported as an allowance for doubtful accounts.

Fixed Assets

Equipment is valued at actual or estimated historical cost. Depreciation expense is computed on a straight-line basis for equipment over a period of five to ten years. Amortization of intangible assets is computed on a straight-line basis over a period of three to seven years and is applied directly to the asset balance. All fixed assets are recorded in the New Fund. Because the State Fund administers the Old Fund, the Old Fund does not carry fixed assets.

Effective July 1, 1997, the fixed asset capitalization limit for the State of Montana was increased from $1,000 to $5,000. This change affected assets purchased during fiscal year 1997-98 and prior fiscal years. The New Fund financial statements for the fiscal year ended June 30, 1997, have been restated to compare with the financial statements for the fiscal year ended June 30, 1998. The effect on prior years' purchases amounted to a $1,042,536 reduction of fund equity and is shown as a prior year adjustment to fund equity. The effect on fiscal year 1997-98 amounted to a $47,689 increase in expenditures and is reflected as a portion of current year operating expenses on the statement of operations and changes in equity.

Advanced Deposits

Security deposits are deposits by certain policyholders that secure payment of premiums.

Deferred Revenue

Deferred revenue reflect amounts in advance that are received or billed, but not yet earned for policies effective July 1, 1998, or July 1, 1997.

Premiums

The State Fund Board of Directors approves premium rates annually. Policies are effective July 1 through June 30 of each fiscal year. Revenue from premiums is recognized over the term of the year.

Policyholders are contractually obligated to pay certain premiums to the State Fund in advance of the period the premiums are earned. Premium advances are refundable when the policyholder's coverage is canceled and all earned premiums have been credited by the State Fund.

Fund Equity

Fund Equity consists of the net excess or deficit of assets over liabilities.

Presentation

The financial statements are presented in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board. State Fund insurance operations are classified as an Enterprise Fund, Proprietary Fund type.

The Enterprise Fund of the State Fund is part of, but does not comprise, the entire Enterprise Fund of the State of Montana. The financial statement in this report reflects the financial position and results of operations and cash flows of the State Fund (New Fund and Old Fund), not the State of Montana.

The Enterprise Fund is used to account for operations: (a) financed and operated in a manner similar to private business enterprises, where the legislature intends that the entity finance or recover costs primarily through user charges; or (b) where the legislature has decided that periodic determination of revenues earned, expenses incurred, or net income is appropriate.

Effective July 1, 1997, the State of Montana and the State Fund implemented Governmental Accounting Standards Board (GASB) Statement No. 31 - Accounting and Financial Reporting for Certain Investments and External Investment Pools. The New Fund financial statements for the fiscal year ended June 30, 1997, have been restated to compare with the financial statements for the fiscal year ended June 30, 1998.

According to GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, STIP is considered an external investment pool. An external investment pool is defined as an arrangement that pools the monies of more than one legally separate entity and invests, on the participant's behalf, in an investment portfolio. STIP is also classified as a "2a7-like" pool. A 2a7-like pool is an external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but has a policy that it will and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. If certain conditions are met, 2a7-like pools are allowed to use amortized cost rather than fair value to report net assets to compute unit values. The Board of Investments has adopted a policy to treat STIP as a 2a7-like pool.

As a governmental entity, the State Fund is required to follow rules promulgated by the Governmental Accounting Standards Board. A private insurance carrier reporting under GAAP accounting rules would follow Financial Accounting Standards Board statement 115 (FASB 115) as their guideline in reporting changes in market values of investments held to maturity. The State Fund holds its investments to maturity and as such followed FASB 115 prior to the implementation of GASB 31.

A comparison of the GASB 31 and FASB 115 treatments on the New Fund financial statements, under a held-to-maturity classification of investments, reveals:

	GASB 31	**FASB 115**
Underwriting Gain/Loss	$8,740	$8,740
FY 98 Market Valuation Effect	11,227	
Other Investment Income	33,909	33,909
Operating Transfers Out	(10,000)	(10,000)
Net Income	$43,876	$32,649
Residual Equity Transfer	(63,800)	(63,800)
Beginning Surplus	159,426	159,426
Prior Year GASB 31 Adjustment	3,788	
Prior Year Adjustment	(1,043)	(1,043)
Ending Surplus 6/30/98	$142,247	$127,232

See Note 2 for further discussion of the effect of GASB 31.

2. Investments

The amortized cost and market value of the New Fund fixed maturity securities as of June 30, 1998, and June 30, 1997, are as follows:

June 30, 1998	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Market Value
U. S. Treasury Securities	$92,502,708	$5,849,312	$0	$98,352,020
U.S. Government Agencies And U. S Government Guaranteed Securities	$41,923,567	$1,054,294	$43,046	$42,934,815
Corporate Securities				
Asset-Backed	$ 67,636,219	$598,229	$3,935	$68,230,513
Other Corporate Securities	$198,958,334	$7,221,862	$85,038	$206,095,158
Other Securities	$ 10,999,673	$424,089	$242	$11,423,520
STIP	$15,326,427	$0	$0	$15,326,427
Totals	**$427,346,928**	**$15,147,786**	**$132,261**	**$442,362,453**

June 30, 1997	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Market Value
US Treasury Securities	$108,487,612	$2,443,459	($955,831)	$109,975,240
US Government Agencies and US Government Guaranteed Securities	$79,126,315	$459,147	($971,965)	$78,613,497
Corporate Securities				
Asset Backed	$65,590,669	$134,274	($120,265)	$65,604,678
Other Corporate Securities	$177,197,105	$3,281,350	($747,567)	$179,730,888
Other Securities	$4,995,284	$266,016	0	$5,261,300
STIP	$25,472,672	0	0	$25,472,672
Totals	**$460,869,657**	**$6,584,246**	**($2,795,627)**	**$464,658,275**

The amortized cost and estimated market value of fixed maturity securities as of June 30, 1998, and June 30, 1997, are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Market Value
June 30, 1998		
Due one year or less	$25,458,153	$25,466,273
Due after one year through five years	$158,054,481	$161,724,116
Due after five years through ten years	$214,337,241	$224,690,001
Due after ten years	$29,497,054	$30,482,063
Totals	**$427,346,928**	**$442,362,453**
June 30, 1997		
Due one year or less	$ 36,576,315	$ 36,680,505
Due after one year through five years	129,895,316	130,659,507
Due after five years through ten years	217,001,659	218,127,758
Due after ten years	77,396,367	79,190,505
Totals	**$460,869,657**	**$464,658,275**

During fiscal year ending June 30, 1998, the New Fund realized gross gains from sales of securities of $1,302,709 and gross realized losses of $41,776. During fiscal year ending June 30, 1998, the Old Fund realized $1,728 in gross gains from sales of securities and no gross realized losses.

During fiscal year ending June 30, 1997, the New Fund realized gross gains from sales of securities of $1,532,941 and gross realized losses of $861,696. During fiscal year ending June 30, 1997, the Old Fund realized $2,474,238 in gross gains from sales of securities and $275,636 in gross realized losses.

Effective July 1, 1997, the State of Montana and the State Fund implemented Governmental Accounting Standards Board (GASB) Statement No. 31 - Accounting and Financial Reporting for Certain Investments and External Investment Pools. GASB 31 requires that all governmental entities report investments at fair value rather than historical or amortized cost. Fair value is defined as the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

As of June 30, 1998, the value of the New Fund's portfolio was increased more than $15 million to reflect the market value of all owned securities. Because GASB 31 was effective July 1, 1997, a portion of this $15 million increase was attributable to years prior to fiscal year 1997-98. Investment income for fiscal year 1996-97 has been increased $4.1 million to reflect the amount of revaluation for all prior years. A prior year adjustment of ($394,000) has been applied to the June 30,1996, ending surplus to reflect the adjustment necessary for years prior to fiscal year 1996-97. Fiscal year 1997-98 investment income has been increased $11.3 million due to the change in valuation mandated by GASB 31.

During fiscal year 1997-98 the Old Fund began investing in long-term bonds. The GASB 31 effect on the Old Fund for the current year was $168,665. There was no prior-year effect on the Old Fund financial statements.

3. Reinsurance

For the two fiscal years ended June 30, 1998, the State Fund ceded reinsurance to other insurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against losses over stipulated amounts. During fiscal year 1997-98, the State Fund retained the first $1.5 million of each loss and $500,000 in aggregate annual deductible while reinsurers were liable for losses in excess of $2 million up to a limit of $50 million on occurrences involving multiple claimants. Individual, per person coverage was provided up to $5 million per claimant with the State Fund retaining the first $2.5 million. During fiscal year 1996-97, the State Fund retained the first $1.25 million of each loss and $750,000 in aggregate annual deductible, while reinsurers were liable for losses in excess of $2 million up to a limit of $50 million on occurrences involving multiple claimants. Individual, per person coverage was provided up to $5 million per claimant with the State Fund retaining the first $2 million. This per person coverage is subject to an annual limit of $10 million. In the event reinsurers are unable to meet their obligations, the State Fund would remain liable for all losses as the reinsurance agreements do not discharge the State Fund from its primary liability to the policyholders.

Effective March 31, 1998, the State Fund purchased reinsurance coverage for Employers' Liability insurance offered to policyholders during fiscal year 1997-98. The State Fund will retain the first $200,000 in ultimate net loss for any one occurrence while reinsurers are liable for losses in excess of $200,000 up to a limit of $1,000,000. The reinsurance coverage provides for two full reinstatements of coverage at no additional cost, which, in total, provides $2,400,000 in ultimate net loss coverage for all occurrences during the seventeen-month term of the current reinsurance agreement.

Premium revenue is reduced by premiums paid for reinsurance coverage of $311,902 and $333,564 in fiscal years 1997-98 and 1996-97, respectively.

Reinsurance had no effect on fiscal year 1997-98 or fiscal year 1996-97 losses and loss adjustment expenses.

4. Risk Management/Public Entity Risk Pool

The Old and New Funds are public entity risk pools. Neither fund had significant reductions in insurance coverage from the prior year, nor any insurance settlements exceeding insurance coverage. Unpaid claims and claim adjustment expenses are estimated based on the ultimate cost of settling the claims including the effects of inflation and other socioeconomic factors.

The New Fund provides liability coverage to employers for injured employees that are insured under the Workers' Compensation and Occupational Disease Acts of Montana. Workers' compensation claims occurring on or after July 1, 1990, are reported in the New Fund. The New Fund must insure any employer who desires coverage. At June 30, 1998, approximately 24,043 employers were insured by the New Fund. At June 30, 1997, approximately 24,823 employers were insured with the New Fund. Anticipated investment income is considered when computing premium rate levels and employers must pay premiums to the State Fund within specified time frames.

Tillinghast-Towers Perrin prepared an actuarial study and estimated liabilities and the ultimate cost of settling claims reported but not settled and claims incurred but not reported for the New Fund as of June 30, 1998 and

June 30, 1997. Because actual claim costs depend on such complex factors as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors.

A provision for inflation and the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. As of June 30, 1998, $310,687,327 of unpaid claims and claim adjustment expenses are presented at face value. As of June 30, 1997, $344,632,133 of unpaid claims and claim adjustment expenses are presented at their net present value of $315,107,230 discounted at an annual rate of 4% on indemnity losses and no discount on medical losses. When the New Fund purchases annuity contracts, the claim is settled in full and on a final basis and all liability of the New Fund is terminated.

State law requires the New Fund to set premiums at least annually at a level sufficient to ensure adequate funding of the insurance program during the period the rates will be in effect. State law also requires the State Fund to establish a minimum surplus balance of 25% of annual premium revenue.

The Old Fund covers the liability and payment of workers' compensation claims for incidents occurring before July 1, 1990. Funding for claims payments is provided by Old Fund Liability Taxes (OFLT) imposed on employer payroll (0.5%), employee wages (0.2%), and sole proprietor and subchapter S shareholder distributive income (0.2%). The OFLT provides funding for Old Fund claim expenses and Old Fund bond payments (see note 5).

An actuarial study prepared by Tillinghast-Towers Perrin for the Old Fund as of June 30, 1998, was used to estimate liabilities and the ultimate cost of settling claims that have been reported, but not settled and claims that have been incurred, but not reported. As of June 30, 1998, $194,401,217 of unpaid claims and claim adjustment expenses are presented at face value. As of June 30, 1997, $205,678,392 of unpaid claims and claim adjustment expenses are presented at face value. Total Old Fund deficit as of June 30, 1998, is $70,585,411 compared to a deficit of $183,182,203 as of June 30, 1997. Estimated claims liability for the Old Fund is presented on an undiscounted basis.

Changes in Claims Liabilities for the Past Two Years
The following table presents changes (in thousands) in the aggregate liabilities for the New Fund and the Old Fund for the past two years. The information presented has not been discounted.

	New Fund		Old Fund	
	1998	1997	1998	1997
Unpaid claims and claim adjustment expenses at beginning of year	$344,632	$402,714	$205,678	$248,802
Incurred claims and claim adjustment expenses:				
Provision for insured events of the current year	69,277	81,046		
Increases (decreases) in provision for events of prior years	(44,165)	(80,752)	3,347	(26,812)
Total incurred claims and claim adjustment expenses	25,112	294	3,347	(26,812)
Payments:				
Claims and claim adjustment expenses attributable to insured events of the current year	(12,942)	(12,589)		
Claims and claim adjustment expenses attributable to insured events of prior years	(46,115)	(45,787)	(14,624)	(16,312)
Total Payment	**(59,057)**	**(58,376)**	**(14,624)**	**(16,312)**
Total unpaid claims and claim adjustment expenses at end of the year	**$310,687**	**$344,632**	**$194,401**	**$205,678**

Risk Management Trend Information
The following table illustrates (in thousands) how the earned revenues of the New Fund plus investment income compare to related costs of loss and other expenses assumed by the State Fund for fiscal years 1991 through 1998. In addition, cumulative amounts related to estimated and actual paid claims are presented. The information allows for comparison of actual and estimated claims and is a basis for developing revenue and claims information. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is used to evaluate the accuracy of incurred claims currently recognized for less mature policy years.

New Fund

	1991	1992	1993	1994	1995	1996	1997	1998
1. Premiums and Investment Revenue								
Earned	$116,886	$156,013	$204,050	$219,380	$181,572	$127,315	$95,765	$77,555
Ceded	231	270	290	318	269	519	348	304
Net Earned	$116,655	$155,743	$203,760	$219,062	$181,303	$126,796	$95,417	$77,251
2. Unallocated expenses including overhead	9,909	11,723	10,760	14,416	15,941	18,996	14,575	17,338
3. Estimated losses and expenses, end of accident year								
Incurred	$133,819	$183,425	$186,480	$199,890	$164,628	$95,067	$76,067	$64,983
Ceded	0	0	0	0	0	0	0	0
Net Incurred	133,819	183,425	186,480	199,890	164,628	95,067	76,067	64,983
4. Net paid (cumulative) as of:								
End of policy year	17,618	20,244	18,347	18,693	18,137	15,818	12,589	12,943
One year later	44,335	50,576	46,343	45,947	40,473	32,890	28,451	
Two years later	64,079	68,837	62,717	60,971	52,073	42,361		
Three years later	74,901	77,950	71,666	67,576	58,722			
Four years later	81,747	83,173	76,280	72,212				
Five years later	85,924	86,461	80,165					
Six years later	88,532	89,370						
Seven years later	91,235							
5. Re-estimated ceded losses and expenses	0	0	0	0	0	0	0	0
6. Re-estimated net incurred losses and expense:								
End of policy year	$133,819	$183,425	$186,480	$199,890	$164,628	95,067	76,067	64,983
One year later	166,980	184,968	184,030	184,920	124,123	88,923	67,235	
Two years later	160,272	175,218	167,052	135,472	107,074	77,286		
Three years later	151,554	161,184	133,017	116,756	95,456			
Four years later	141,389	135,775	120,583	107,656				
Five years later	130,250	125,084	111,208					
Six years later	121,568	119,780						
Seven years later	118,856							
7. Increase (decrease) in estimated net incurred losses and expenses from end of policy year	(14,963)	(63,645)	(75,272)	(92,234)	(69,172)	(17,781)	(8,832)	

Item 2, Item 3 and Item 6 ("End of policy year" line) have been restated due to incorrect inclusion of unallocated loss adjustment expenses in lines 3 and 6 in prior years. The Trend Information table has been expanded from 6 categories to 7 categories and shows the effect of ceded reinsurance as required by GASB 30 which amended GASB 10.

5. Payroll Tax Bonds (Workers' Compensation Program)

The Montana Board of Investments issued $142,095,000 of bonds on July 15, 1991, (Workers' Compensation Program Series 1991) for the purpose of funding the state's liability and costs in administering and paying claims for injuries resulting from accidents prior to July 1, 1990, that are subject to the Montana Workers' Compensation Act and the Occupational Disease Act of Montana.

Using cash determined by the State Fund to be in excess of the amount needed to pay claims occurring prior to July 1, 1990, the Board of Investments provided for two early defeasances of $20,880,000 and $13,075,000 in the Workers' Compensation Program Series 1991 bonds. On July 24, 1995, and March 26, 1996, the Board deposited $21,528,449 and $13,521,916, respectively, with an escrow agent and invested in federal securities to provide for the future debt service payments until the bonds mature through June 1, 2020. Both transactions met the requirements of a legal defeasance. The $20,880,000 and $13,075,000 in Series 1991 Bonds maturing through June 1, 2020, were removed from the State Fund's accounting records in July 1995 and March 1996. The fiscal year 1996 loss related to these early bond defeasances totaled $1,709,046. This amount relates to the write-off of original bond discount and cost of issuance and bond premium paid for early redemption.

Using cash from the declaration of a dividend, cash available from the bond reserve and cash determined by the State Fund to be in excess of the amount needed to pay claims occurring prior to July 1, 1990, the Board of Investments provided for the final retirement of $97,885,000 in Workers' Compensation Program Series 1991 bonds. On October 3, 1996, the Board deposited $99,384,056 with an escrow agent and invested in federal securities to provide for the future debt service payments until the bonds mature through June 1, 2020. The transaction met the requirements of a legal defeasance. The $97,885,000 in Series 1991 bonds maturing through June 1, 2020, were removed from the State Fund's accounting records in October 1996. The fiscal year loss related to the bond defeasance totaled $3,208,210. The net loss constitutes a final write-off of the original bond discount and cost of issuance that was being amortized over the life of the bonds and a gain associated with the federal securities acquired for the defeasance.

In completing the three bond defeasances described above, the Board of Investments reserved the right to substitute other government securities or cash into the Workers' Compensation Program Series 1991 escrow as long as the substitution was sufficient to retire the bonds. In December 1996 the Board of Investments chose to sell an option to a third party to purchase the escrowed securities on or after November 1, 2008, for a price sufficient to redeem all the Series 1991 bonds. The bid process resulted in net option premium proceeds of $2,284,940 to maximize the yield of the escrowed securities. These proceeds, received on January 3, 1997, and recorded in the Old Fund, reflected investment gain and expense of $2,456,310 and $171,370, respectively.

On October 27, 1993, the Board of Investments issued $32,500,000 in Variable Rate Payroll Tax Bonds (Workers' Compensation Program Series 1993) to pay the costs associated with claims incurred on or before June 30, 1990.

Using cash from the declaration of a dividend, cash available from the bond reserve and cash determined by the State Fund to be in excess of the amount needed to pay claims occurring prior to July 1, 1990, the Board of Investments provided for the full retirement of $32,500,000 in Workers' Compensation Program Series 1993 bonds. On January 2, 1997, the Board of Investments paid $32,604,037, principal and interest, to the trustee as final payment on the Series 1993 bonds. The transaction met the requirements of a legal defeasance. The fiscal year 1997 net loss related to the bond redemption totaled $326,990. The net loss represents the final write-off of the cost of issuance that was being amortized over the life of the bonds.

6. Administrative Cost Allocation

State law requires the State Fund to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990, (Old Fund) from those occurring on or after July 1, 1990, (New Fund). The law also limits annual administrative costs of claims associated with the Old Fund to $3 million. The State Fund allocated $2.396 million and $2.975 million in administration costs to the Old Fund in fiscal years 1997-98 and 1996-97, respectively. The Old Fund has a $20,674 obligation to the New Fund in unrecovered administrative costs incurred in previous years. The New Fund intends to recover this amount in future years where the cost of administering the Old Fund is less than the statutorily permitted $3 million.

7. New Fund Surplus Distributions

i. Dividend Paid to Old Fund

During fiscal year 1996-1997, the New Fund paid approximately $102.3 million to the Old Fund as a dividend to defease payroll tax bonds as discussed in Note 5, above. During fiscal year 1997-98, the New Fund paid $63.8 million to the Old Fund in accordance with the provisions of section 39-71-2316 (2), MCA, to provide sufficient funding for future payment of Old Fund claims.

ii. Payment to State General Fund

Section 39-71-2320 (2), MCA, provides for the payment of $10 million by the New Fund to the State's General Fund in each of the fiscal years ending June 30, 1998, and June 30, 1999. When completed, this will repay in full the $20 million appropriation made to the Old Fund during the June 1989 Special Legislative Session in lieu of a 22% rate increase originally planned at that time.

The fiscal year 1997-98 payment was accomplished during June 1998 and is reflected in the financial statement as an operating transfer out. The $10 million to be paid during fiscal year 1998-99 has been shown in the current financial statements as a reservation of fund balance.

8. Compensated Absences

Employees at the State Fund accumulate both annual and sick leave. The State Fund pays employees for 100% of unused annual leave and 25% of unused sick leave upon termination. The fund pays 100% of unused compensatory leave credits upon termination to nonexempt employees. The State Fund absorbs expenditures for termination pay in its annual operational costs. The State Fund had a total leave liability of $768,172 and $709,749 at June 30, 1998, and June 30, 1997, respectively.

9. Pension Plan

The State Fund and its employees contribute to the Public Employees Retirement System (PERS) a mandatory multiple-employer, cost-sharing, defined benefit pension plan administered by the State of Montana Public Employees Retirement Division (PERD). The PERS offers retirement, disability, and death benefits to plan members and their beneficiaries. Established in 1945, the plan is governed by Title 19, chapters 2 and 3, MCA. PERS participants are eligible to retire at age 60 with at least five years of service, at age 65 regardless of length of service or at 30 years of service regardless of age. Actuarially reduced retirement benefits may be taken with 25 years of service or at age 50 with a minimum of five years of service. Monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average salary. Vesting occurs once membership service totals 5 years. The authority to establish and amend contribution rates and to provide cost of living adjustments for the plan is assigned to the State legislature. State Fund and its employees each were required to contribute 6.8% of annual compensation in fiscal year 1997-98 and 6.7% of annual compensation in fiscal years 1996-97 and 1995-96. This amounted to $917,989 for fiscal year 1997-98, $826,442 for fiscal year 1996-97, and $829,188 for fiscal year 1995-96. State Fund and its employees paid One hundred percent of required contributions to PERS and there is no unpaid liability as of June 30, 1998.

The PERS financial information is reported in the Public Employees' Retirement Board *Comprehensive Annual Financial Report* for the fiscal year-end. It is available from the PERD at 1712 Ninth Avenue, P. O. Box 200131, Helena, MT 59620-0131, 406/444-3154.

10. Building

The 1981 Legislature appropriated funds for the construction of a Workers' Compensation building. As of July 1, 1990, the State Fund transferred the value of the building from its records to the Department of Administration which owns most other state buildings and charges agencies rent for their use. Under the agreement, the State Fund will pay all costs associated with the building including utilities, property taxes, janitorial services, and maintenance in lieu of paying rent.

11. Contingencies

In prior years the State Fund purchased single premium annuities from Confederation Life Insurance Company (the Company), Atlanta, Georgia, to settle claims. The Company has been placed in bankruptcy rehabilitation by the Michigan Insurance Department. State Fund legal counsel has reviewed the rehabilitation plan (Plan) of Confederation Life Insurance Company. There were twelve Old Fund claims with annuities with the Company. The outstanding balances on the annuities amounts to $250,388. The Plan anticipates full payment of annuity contracts. State Fund will continue to monitor the execution of the Plan.

Broeker v. State Fund The issue in this case involved the method insurers used to calculate the social security disability insurance (SSDI) offset rates on certain claims. The Workers' Compensation Court decision stated that where there is a cost of living increase built into the initial entitlement to social security disability benefits, the workers' compensation insurer cannot take the cost of living increase into consideration when computing the SSDI offset rate. On appeal, the Montana Supreme Court affirmed the Workers' Compensation Court decision. This decision affects prior unsettled claims and similarly situated claimants that will receive benefits in the future. Because these claims have not been identified, no calculation of potential benefits due has been made. This matter is currently before the Workers' Compensation Court for implementation of the Supreme Court's decision. The Workers' Compensation Court has requested the Social Security Administration's assistance in identifying affected claims.

Murer, et al. v. Montana State Compensation Mutual Insurance Fund, et al. This case involves the 1987 legislature's limiting of workers' compensation benefits for injuries occurring during the period July 1, 1987, through June 30, 1989. The 1989 legislature reenacted those limits for injuries occurring during the period July 1, 1989, through June 30, 1991.

The Montana Supreme Court found that those limits should have expired on June 30, 1989, for injuries occurring during the period July 1, 1987, through June 30, 1989, and should have expired on June 30, 1991, for injuries occurring during the period July 1, 1989, through June 30, 1991.

The State Fund is in the process of reviewing about 7,500 claims to determine qualification for increased benefits due to expiration of the limits instituted by the 1987 and 1989 legislative sessions.

Chacon v. State Fund This case arose from a Chapter 7 bankruptcy filing objection to the State Fund filing a priority tax claim for unpaid workers' compensation insurance premiums. Since 1987, the State Fund's bankruptcy proofs of claim have been granted priority tax claim status in the Montana Bankruptcy Court. In this case the Bankruptcy Court held that claims for unpaid premiums are in the nature of fees and are not entitled to priority tax claim treatment in bankruptcy proceedings.

The State Fund currently has approximately $980,000 in bankruptcy claims that may be potentially impacted by this decision. The future impact upon unpaid premium claims is impossible to predict. Relegation of State Fund claims to general unsecured creditor status reduces the probability of recovery in bankruptcy cases.

The State Fund has appealed the decision to the 9th Circuit Court of Appeals and is currently being briefed before the U. S. District Court.

Una (Van Horn) Killion v. State Fund This case challenges the constitutionality of section 39-71-721 (5), MCA, that provides for payment of death benefits to a surviving spouse. The law indicates a surviving spouse is allowed to receive death benefits for a period of 500 weeks or until remarriage. The case alleges the current law invades personal privacy and discriminates based on marital status.

The case was heard before the Workers' Compensation Court in July 1998 and a decision is expected before December 31, 1998. The potential cost impact, if any, has not yet been determined.

12. Subsequent Event

On September 16, 1998, the State Fund Board of Directors recommended to the Budget Director that the Old Fund Liability Tax could end on January 1, 1999. Subsequently, the Budget Director in compliance with 39-71-2505 (7), MCA, communicated to the Director of the Revenue Department that collection of the Old Fund Liability Tax could cease effective January 1, 1999.

STATE FUND MONTANA

STATE COMPENSATION INSURANCE FUND

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P.O. BOX 4759
HELENA, MONTANA 59604-4759

General Information (406) 444-6500

Carl W. Swanson, President
Executive (406) 444-6518

November 25, 1998

RECEIVED NOV 30 1998

Mr. Scott A. Seacat
Legislative Audit Division
Room 135
State Capitol Building
Helena, Montana 59620-1705

Dear Mr. Seacat:

I want to thank the Legislative Audit Division staff for the work performed on our financial compliance audit for the fiscal year ended June 30, 1998. We also appreciate your work in issuing an unqualified audit opinion with no recommendations. The State Fund is committed to be the insurance carrier of choice and industry leader in service for all of our Montana customers. The State Fund's commitment to the state of Montana is evident during the past year with the New Fund contribution of $63.8 million dollars to the Old Fund, and a $10 million dollar repayment to the General Fund. This makes the total New Fund contributions to the Old Fund just over $166 million dollars. As a result of these contributions and taxes paid from Montana employers and employees, the Old Fund Liability Tax (OFLT) will end December 31, 1998.

In addition to the termination of the OFLT, the State Fund has reduced rates for Montana businesses by 38.1% over the last four years. Our commitment to maintain a sound financial position enables the State Fund to absorb fluctuations in the market, including the potential for adverse loss development and medical inflation. The State Fund continually seeks to improve its operations, product selection, and pricing mechanisms to ensure that we provide a competitive option for all Montana businesses. As a result of sound business decisions, the Montana State Fund is poised to meet the current and future service needs of its stakeholders.

Sincerely,

Carl W. Swanson

Carl W. Swanson
President/CEO

Claims Department 1-800-332-6102 · First Report of Accident 1-800-243-9121 · Underwriting Department 1-800-336-8968
Fraud Hotline 1-800-922-2873 · Loss Control/Premium Audit (406) 444-6584 · TDD (406) 44-5971